

2016

MORTGAGE TAX REPORT

SOMOS CUNY INTERNSHIP

**SAINT MBAKOP A BOUI
MICHAL SLOWIK
TAKO CHKADUA
MUHAMMAD DALHATU**

ASSEMBLYMEMBER: ERIK M.
DILAN | District 54

I. Abstract

After the foreclosure crisis of 2008, the dynamics of the American housing market changed drastically. The biggest impact can be seen in New York City on the local level and more specifically in low income communities. In those communities and others people are being pushed out of their homes at an alarming rate for the purpose of refurbishing houses and selling them for profits, process known as “flipping”. While investors profit from accumulating more land in communities, lifelong tenants can no longer afford the spike in prices such as mortgage or rent. To address this issue, we should look on having a “flip tax” proposed at the New York State level that will trickle down into all five boroughs of NYC, similar to the legislations proposed in Philadelphia and San Francisco.

II. Introduction body

A mortgage recording tax is a tax imposed on the “privilege” of legitimizing the mortgage and making it an official transaction. Although this tax is applicable on all mortgage transaction, it is only practiced in 7 out of 50 states. These states are Alabama, Florida, Kansas, Minnesota, New York, Oklahoma and Tennessee¹. Additionally, “New York City, Yonkers, and various counties impose local taxes on mortgages that are recorded in those jurisdictions.”² The New York State Department of Finance summarizes the current mortgage tax laws in the following:

“The six taxes are: (i) the basic tax imposed by section 253(l) of the Tax Law, (ii) the special additional tax imposed by section 253 (1 -a) of the Tax Law, (iii) the additional tax imposed by section 253(2)(a) of the Tax Law, (iv) the New York City Tax that is

¹ Godard, Terry (<https://smartasset.com/mortgage/mortgage-taxes>)

² <http://codes.findlaw.com/ny/tax-law/tax-sect-253.html>

authorized to be imposed by section 253- of the Tax Law, (v) the City of Yonkers Tax that is authorized to be imposed by section 253-d of the Tax Law and (vi) the Broome County Tax that is authorized to be imposed by section 253-c of the Tax Law. With certain exceptions, the rate of the mortgage recording tax varies from a total tax rate of a minimum of \$.75 to a maximum of \$2.75 for each \$ 100 of the amount secured by the mortgage³.”

The above outlined mortgage tax laws reference to the New York State Law 253 and its sections. This law can be found in Appendix A. with the mortgage and the mortgage tax come along the problem of foreclosures which is the process of taking possession of a mortgaged property as a result of the mortgagor's failure to keep up mortgage payments or property tax payment.

Foreclosures happen for many reasons in the housing market. One example is failing to keep up with the property taxes on one’s home can lead to a tax foreclosure. For New York State, there is a special procedure that must first be defined. When a tenant or a homeowner fails to pay his or her taxes, the owed amount (compounded by interest rates) is then called a “lien” on their home. A lien is a legal claim on your property, the taxing authority can then foreclosure the lien to collect the overdue amounts. Once this occurs a notice of your home's foreclosure will be published in a newspaper on date of the publication the enforcing officer is required to notify you that the foreclosure has started. There is an existing right for individuals to redeem your homes in New York. The redemption period expires two years after they lien date - local law may provide a longer redemption period⁴. Homes that fall prey to foreclosure are picked up by domestic and/or foreign investors who later may choose to “flip” the property.

³ NYS Department of Taxation and Finance (https://www.tax.ny.gov/pdf/memos/mortgage/m96_2r.pdf)

⁴ N.Y Real Prop. Tax Law 1110

When it comes to property tax in New York State, homeowners are subject to a transfer tax when the property ownership is passed from one body to another. A transfer is a real estate transfer tax on conveyances of real property or interests therein when the consideration exceeds \$500. The tax is paid by the seller. However, if the grantor doesn't pay the tax or is exempt from the tax, the buyer must pay the tax. This is the most common situation for low income communities in New York City. A flip tax is a proposal that would impose a steep tax on flippers who buy properties and sell it within a 5 year time frame.

III. Problem Definition

A homeowner can default into a foreclosure crisis in different ways. In this report we will focus on the two most common ways in New York, which include mortgage loans and government taxes. Mortgage loans is known as a process in which an individual borrows money from the bank to be able to buy a residential property. Failure to make payment on the mortgage can cause a homeowner to default on the mortgage payment in which the Bank can foreclose the house. This process involves the Bank putting the house back on the market.

The second category is based on government taxes such as the property tax. Property taxes are generally paid by the mortgage lender which means a borrower must pay additional funds for property taxes to the lender along with the principal and interest rates as part of the monthly payment. But the homeowner can also decide to pay their mortgage tax by themselves. When a homeowner fails to pay their property taxes for one reason or another, the taxing authority initiates a tax sale due to the first lien status of a property tax. This is one of many ways in which flippers determine the potential houses they can flip. With that brings forth the different methods used by flipper to gain possession of a property, these methods are not always legal as in the case of buyout.

Illegal buyout is the process in which a landlord force tenants to accept meager buyouts to vacant their apartments. Such offers are rarely helpful to for tenants to settle in elsewhere in the city. If a tenant declines, buyouts lead to illegal harassment and while increase the growing threat to the housing market. Such harassment can be seen where tenants are forced out of their homes through intimidation tactics such as forceful evictions or fake court papers. Some landlord even hire relocation specialist who receive a fee for each vacancy. There are state and city laws that prohibit conduct meant to force tenants to vacate an apartment or waive tenancy rights. In 2008, a city law was implemented specifically bans interrupting essential services, initiating baseless eviction proceedings or locking out a tenant.

Foreclosure creates a market for flippers to come into the community and flip houses. In this case, we will use the term flipper to refer to resident or non-resident, foreign or local, individual or corporation purchasing property for the purpose of renovating and selling it later for profit. This creates few issues in the communities across the country, especially relevant in the 5 boroughs of New York City. Flipping has negative impact on the low income families or those who have lived in the communities for an extended period of time. In general, investment and renovation in a neighborhood has a positive impact and leads to more development. This is not the case with flipping houses.

The negative impact of this form of investment can be summarized by several examples. Firstly, when the house goes into foreclosure, the homeowner's information becomes public. This gives the investors a channel to harass homeowners into selling their houses by constantly contacting them. Secondly, once a house is flipped, it affects the cost of other houses in the neighborhood, whether by increasing the property tax or by increasing the home values due to lack of property availability. Thirdly, if the original house had tenants and the next owner wants

to rent the place, the rent price will be much greater which will eventually have a domino effect on the rent rates in the area. Implementing a flip tax will have a significant impact on flipping as it reduces the hassles low income communities have to deal with when investors come into their communities.

IV. Solution Details

Before we address this issue, we need to identify the root cause of the foreclosures. One cause, is the intensive efforts of investors as they try to sell houses in low income communities; this causes flippers to go into those communities as they try to profit off the foreclosures. Second, financial issues homeowners are facing when meeting the deadlines for their payments. First root problem can be addressed by implementing a tax to discourage such practice in the form of a flip tax. The revenues generated by the flip tax can fund programs that will help homeowners repurchase flipped houses at an affordable price as well as programs that will prevent foreclosure.

The first solution, a flip tax, has to be further evaluated. There are five different types of flip taxes that can be applied to a house purchase transaction and they are differentiated by application of the fee. The first is per share amount which imposes a set dollar amount per share. The second is a flat fee, the process of charging a flat rate for every house sale regardless of the price. The third type is percentage of the sales price, this would require to set a percentage rate which will be applied to the entire sales price. Another option is to charge percentage of net profits. This method is less opaque since you would first have to define what a formula for establishing the net profit amounts. Lastly, one can apply combination of different flip taxes in

one is. For instance, you can apply flip tax as percentage of the sales price if it is greater than the original purchase price⁵.

First, we suggest imposing a flip tax calculated as percentage of the sales price. This would require setting a percentage rate to be applied within the time parameters. Column A displays an example of the original sales price. Column B is various percentage rates that can be applied. Column C is the dollar amount charged based on the original sales price per the flip tax rate presented. To implement this tax, we suggest applying 15% tax rate for houses sold within the first year, 9% after the second year and 3% before 3 years. The revenues generated will be used to fund programs that will help the community. As in the case study of San Francisco which will be further discussed, the proposition of 24 percent flip tax failed because lawmakers believe it was too high. A lower percentage can still have a significant impact as it helps the communities while discouraging flipping and generating revenue.

Column A	Column B	Column C
Sales Price	Flip Tax Rate	Flip Tax Amount
\$500,000	15%	\$75,000
\$500,000	13%	\$65,000
\$500,000	11%	\$55,000
\$500,000	9%	\$45,000
\$500,000	7%	\$35,000
\$500,000	5%	\$25,000
\$500,000	3%	\$15,000
\$500,000	1%	\$5,000

Figure 1: Flip tax calculated as percentage of the sales price

⁵ https://www.cnyc.com/code/newsletters/2002autumn/aut02_008fliptaxes.html

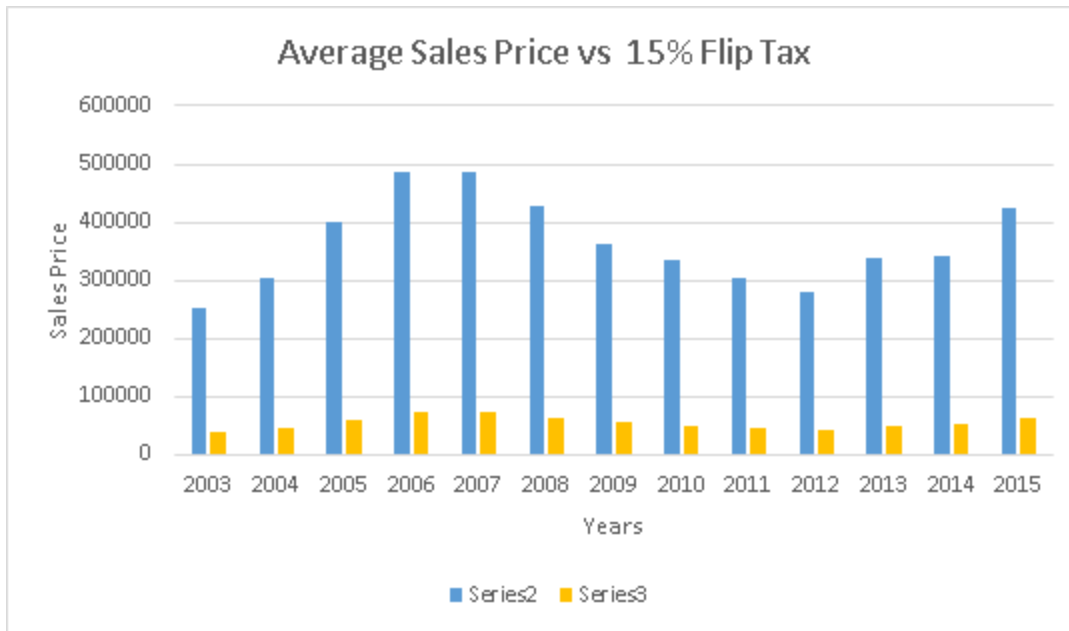


Figure 2: Average sales price between years 2003-2015 and 15% flip tax

The first program suggested is the foreclosure prevention which aims to eliminate the root cause of the problem and aid those at the risk of foreclosure. The first step would be identifying who is risk at foreclosure. In order to achieve this, there needs to be parameters in class to determine qualifications. For instance, if an owner has more than two late or missed payments on their mortgage, they will be offered a financial consultation to ensure they stay on track with all future payments. If the same owner, misses their payments post-consultation, they will have another consultation which will create a budget and offer financial assistance for a 6 months period to stabilize their financial predicament. The program will provide the owners a unique opportunity to manage their budgets with financial counseling as well as provide short term relief while implementing a long term solution.

The second program aims to help original owners re-purchase flipped properties at a reasonable price. This would be more challenging to implement since the government or the revenues generated from the flip tax would not be sufficient to cover the difference of the flip. The best way to address this issue is to create loan programs for those wanting to repurchase

their properties. Similar to the foreclosure prevention program, these loans would be covered by the revenues generated from the flip tax. Unlike a regular loan, this loan would be interest free which would provide more secure alternative to taking a loan from the bank. A financial consultation will also be provided to guide the owner through the process.

Exemptions on flip tax can be made by assessing the financial hardship of a homeowner. A homeowner can be evaluated if they are part of any financial programs provide by the city or state. An example of financial program is the Senior Citizen Home Assistance Program (SCHAP) which was developed in cooperation with private banks and credits unions that loans up to \$30,000 to owner or occupants of one- to four family homes located throughout the City if they wish to improve their properties. The City also provides a grant which reduces the bank's interest rate to 2.5 percent or 5 percent, depending on the borrower's income. An example of another program is the Multifamily Storm Recovery Program which programs forgivable loans or grants for repairs and resiliency improvements to rental buildings, condominiums, and co-operatives with five or more units that sustained damage due to Hurricane Sandy. Other programs may include Participation Loan Program, Affordable Neighborhoods Cooperative Program, Green Housing Preservation Program (GHPP), etc.

Investors can also be differentiated if they part of any homebuyer assistance program or if homeowner or tenant filed a harassment complaint to the city. An example of an assistance program is the HomeFrist Down Payment Assistance Program. Eligibility to the program includes being a first-time homebuyer, must meet the program income eligibility requirements of \$72,050 and pass the Housing Quality Standards (HQS) inspection before purchase, etc. Investors can also be differentiated bases on the harassment which include illegal buyouts as discussed as well as unjustified evictions notices and illegal lockouts.

V. Community Benefits

The implementation of a flip tax is beneficial as it discourages the flipping of private property while providing an ongoing funding source for building reserves and capital improvement⁶. Implementing such taxes works because it spikes the fees and therefore, minimizes personal profits. Additionally, they have to deal with more paperwork for the government. Another major benefit is creation of additional revenues which are currently being used for organizations like the New York Metropolitan Transportation Authority, New York State and the city general trust fund⁷. These revenues could also be used to implement the above proposed programs like foreclosure prevention or assistance.

Opponents of the introducing the flip tax believe that a “tax on housing will not make housing more affordable or plentiful⁸.” considering the current housing market, implementing flip a tax on an investor will make housing more expensive while decreasing individual profit. An example of this can be seen in proposed bill of San Francisco in 2014 which suggested a flip tax rate at 24 percent. If an individual buys a home at a cost of 1 million dollars without a flip tax, they will be paying less than 15 percent in taxes equaling \$150,000. If they were to pay a flip tax. It will be an additional 24 percent equaling \$240,000. This will substantially decrease the individual’s profit because they have to pay a total amount of 39 percent instead of a mere 15 percent.

VI. Case Studies

⁶ <http://cooperator.com/article/flip-taxes-or-transfer-fees/full#cut>

⁷:<http://oemmndcbldboiebfnladdacbfmadadm/http://web.mta.info/mta/ind-finance/budgetWatchMay2016.pdf>

⁸

<http://www.bizjournals.com/sanfrancisco/news/2014/07/24/san-francisco-property-owners-house-flippers.html>

In 2014, San Francisco proposed a real estate transfer tax on any short term flips which was defined as any property between two and thirty units that is bought and sold within less than five years. If the resale fell within one year of the purchase, the tax would have been 24 percent of the resale price. The tax would have declined over the next four years. After five years, the tax would have disappeared. Although the proposition did not pass, supporters of the tax hoped it will keep speculators from flipping apartment buildings, especially rent-controlled units. The tax failed to be implemented due to argument that the measure would have punished ordinary homeowners who need to sell their properties in a hurry because of any crises such as illness, job relocation, etc. Opponents also argued the proposition was written too vigorous due to the 24 percent tax rate as well as the fact that it included two-unit buildings, and homes with in-law units. Such laws allowed landlords to remove rental properties, often rent controlled, from the market. San Francisco voters do acknowledge the fact that there is a real housing crisis and are willing to vote for tax that is less steep as the one proposed⁹.

Philadelphia is also wants to implement a flip tax with already an implementation of a Realty Transfer Tax which has a tax rate 4 percent. The Philadelphia Coalition for Affordable Communities calls for an addition of a flip tax that would increase the Realty Transfer Tax from 4 percent by an additional 1.5 percent for any property selling more than once within 24 months. A research conducted by Econsult found that increasing the Realty Transfer Tax from 4 percent to 5.5 percent on the roughly 6,000 properties that had sold twice or more in two years would have yielded an additional \$12 million for the Housing Trust Fund in 2013. A Trust Fund that established in 2005 to support housing preservation and repair, affordable housing development, and prevent homelessness. With double the resources, the coalition estimated the Housing Trust Fund would be able to fund 240 new affordable rental apartments, assist 150 more homeowners

⁹ <http://www.sfgate.com/bayarea/article/S-F-affordable-housing-advocates-dig-in-for-next-5876874.php>

with basic but critical repairs as well as help renovate 90 homes. It will also provide mortgage and utility assistance to 272 families facing homelessness, and offer 240 capital improvement grants for community garden and food-producing green spaces¹⁰.

VII. Summary

The foreclosure crisis of 2008 has changed the dynamics of the American housing market. Such impact can be seen in New York City as people are being pushed out of their homes and communities at an alarming rate for the purpose of refurbishing and selling their houses for large sum of profit, process known as flipping. Flipping has had a negative impact in on the communities due to the spike in prices of affordable houses. It has also bring forth more harassments homer owners face as they are being pushed out of their homes whether through illegal buyouts or the forceful evictions. As discussed, the implementation of a flip tax will curb the occurring crisis in the communities while generating revenue for the state and city.

APPENDIX

Appendix A: Tax Laws

¹⁰

<http://planphilly.com/articles/2015/03/31/advocates-for-affordable-communities-call-for-anti-speculation-tax>

1. A tax of fifty cents for each one hundred dollars and each remaining major fraction thereof of principal debt or obligation which is, or under any contingency may be secured at the date of the execution thereof or at any time thereafter by a mortgage on real property situated within the state recorded on or after the first day of July, nineteen hundred and six, is hereby imposed on each such mortgage, and shall be collected and paid as provided in this article. If the principal debt or obligation which is or by any contingency may be secured by such mortgage recorded on or after the first day of July, nineteen hundred and seven, is less than one hundred dollars, a tax of fifty cents is hereby imposed on such mortgage, and shall be collected and paid as provided in this article.

1-a. (a) In addition to the tax imposed by subdivision one of this section, there shall be imposed on each mortgage of real property situated within the state, except mortgages wherein the mortgagee is a natural person or persons, or is a credit union as defined in section two of the banking law, and in either case the mortgaged premises consist of real property improved by a structure containing six residential dwelling units or less, each with separate cooking facilities, a special additional tax of twenty-five cents for each one hundred dollars and each remaining major fraction thereof of principal debt or obligation which is, or under any contingency may be secured at the date of execution thereof or at anytime thereafter by such mortgage. The tax, if any, imposed by this subdivision shall in cases of real property principally improved or to be improved by one or more structures containing in the aggregate not more than six residential dwelling units, each dwelling unit having its own separate cooking facilities, be paid by the mortgagee, and such tax shall not be paid or payable, directly or indirectly, by the mortgagor except as otherwise provided in sections two hundred fifty-eight and two hundred fifty-nine of this article and except such tax shall be paid in such cases by the mortgagor where the mortgagee

is an exempt organization described in paragraph (b) of this subdivision. In all other cases, such tax shall be paid by the mortgagor except that the tax shall be paid by the mortgagee where the mortgagor is an exempt organization described in paragraph (b) of this subdivision. All of the provisions of this article shall apply with respect to the special additional tax imposed by this subdivision to the same extent as if it were imposed by said subdivision one of this section, except as otherwise expressly provided in this article.

2. (a) In addition to the taxes imposed by subdivisions one and one-a of this section, there shall be imposed on each mortgage of real property situated within the state recorded on or after the first day of July, nineteen hundred sixty-nine, an additional tax of twenty-five cents for counties outside of the metropolitan commuter transportation district, as defined pursuant to section twelve hundred sixty-two of the public authorities law, and thirty cents for counties within such metropolitan commuter transportation district for each one hundred dollars and each remaining major fraction thereof of principal debt or obligation which is, or under any contingency may be secured at the date of execution thereof or at any time thereafter by such mortgage, saving and excepting the first ten thousand dollars of such principal debt or obligation in any case in which the related mortgage is of real property principally improved or to be improved by a one or two family residence or dwelling. All the provisions of this article shall apply with respect to the additional tax imposed by this subdivision to the same extent as if it were imposed by the said subdivision one of this section, except as otherwise expressly provided in this article. The imposition of this additional tax on mortgages recorded in a county outside the city of New York, other than one of the counties from time to time comprising the metropolitan commuter transportation district, the Niagara Frontier transportation district, the Rochester-Genesee transportation district, the capital district transportation district or the central

New York regional transportation district may be suspended for a specified period of time or without limitation as to time by a local law, ordinance or resolution duly adopted by the local legislative body of such county.

Appendix B: Estimated Revenues Generated by 15% flip tax

2013	\$21,939,848
2014	\$23,667,383
2015	\$31,364,351